

BANK OF CANADA

The target for the overnight rate stays at 1.00%

The BoC is raising its forecasts... but there are still major risks

ACCORDING TO THE BANK OF CANADA (BoC)

- The target for the overnight rate remains at 1.00%.
- Global growth is expected to strengthen over the next two years, rising from 2.9% in 2013 to 3.4% in 2014 and 3.7% in 2015. The United States will lead this acceleration.
- In Canada, growth improved in the second half of 2013. However, there have been few signs of the anticipated rebalancing towards exports and business investment. Stronger U.S. demand, as well as the recent depreciation of the Canadian dollar, should help to boost exports and, in turn, business confidence and investment.
- Real GDP growth is projected to pick up from 1.8% in 2013 to 2.5% in both 2014 and 2015. This implies that the economy will return gradually to capacity over the next two years.
- The path for inflation is now expected to be lower than previously anticipated for most of the projection period. The BoC expects inflation to return to the 2% target in about two years, as the effects of retail competition dissipate and excess capacity is absorbed.
- The downside risks to inflation have grown in importance. At the same time, risks associated with elevated household imbalances have not materially changed.
- The BoC judges that the balance of risks remains within the zone articulated in October, and therefore has decided to maintain the target for the overnight rate at 1%. The timing and direction of the next change to the policy rate will depend on how new information influences this balance of risks.

COMMENTS

As forecast, recent movement by economic indicators prompted the BoC to raise its economic forecasts somewhat. Real GDP expected for 2013 rose from 1.6% to 1.8%, matching our scenario. The BoC's growth forecast for 2014 has also been revised upwards, from 2.3% to 2.5%.

That said, there are still significant risks clouding the economic outlook. Exports in particular are still not managing to take advantage of rebounding U.S. and global

demand. Much hope rests on accelerating exports and non-residential investment to underpin growth in the coming quarters.

Downside risks on inflation have also intensified. Forecasts were revised downwards throughout 2013, even though the effects of excess production capacity and fierce competition in retail trade had a stronger-than-expected impact. Under these conditions, the gradual rise in inflation forecast for 2014 could be much less pronounced than expected. In contrast, worries still linger concerning the vitality of the housing market and household debt, despite some signs of improvement. Clearly, the monetary authorities believe these risks are currently balanced.

Implications: The balance of risks will determine monetary policy in the coming quarters. The door is still open for key interest rates to eventually go down if inflation holds steady well below the lower target for a long enough period. In the short term, this possibility will continue to apply downward pressure on the Canadian dollar. Lower key interest rates are nonetheless unlikely, and everything suggests that the coming quarters will instead see stable key interest rates. An initial hike in the target for the overnight rate could be ordered in the second half of 2015, once excess production capacity is mostly absorbed.

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NOTE TO READERS: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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Schedule 2014 of Central Bank meetings

	<u>Decision</u>	<u>Rate</u>		<u>Decision</u>	<u>Rate</u>	
JANUARY			JULY			
9	European Central Bank	s.q.	0.25	1	Reserve Bank of Australia	
9	Bank of England	s.q.	0.50	2	Bank of Sweden	
15	Bank of Brazil	+50 b.p.	10.50	3	European Central Bank	
22	Bank of Canada	s.q.	1.00	10	Bank of England	
22	Bank of Japan	---	---	11	Bank of Mexico	
29	Federal Reserve			15	Bank of Japan	
30	Reserve Bank of New Zealand			16	Bank of Brazil	
31	Bank of Mexico			16	Bank of Canada	
FEBRUARY			AUGUST			
4	Reserve Bank of Australia			5	Reserve Bank of Australia	
6	European Central Bank			7	European Central Bank	
6	Bank of England			7	Bank of England	
12	Bank of Sweden			8	Bank of Japan	
18	Bank of Japan			SEPTEMBER		
26	Bank of Brazil			2	Reserve Bank of Australia	
MARCH			OCTOBER			
4	Reserve Bank of Australia			2	European Central Bank	
5	Bank of Canada			7	Reserve Bank of Australia	
6	European Central Bank			7	Bank of Japan	
6	Bank of England			9	Bank of England	
11	Bank of Japan			22	Bank of Canada	
13	Reserve Bank of New Zealand			23	Bank of Norway	
19	Federal Reserve			27	Bank of Sweden	
20	Swiss National Bank			29	Bank of Brazil	
21	Bank of Mexico			29	Federal Reserve	
27	Bank of Norway			30	Reserve Bank of New Zealand	
APRIL			NOVEMBER			
1	Reserve Bank of Australia			4	Reserve Bank of Australia	
2	Bank of Brazil			6	European Central Bank	
3	European Central Bank			6	Bank of England	
8	Bank of Sweden			19	Bank of Japan	
8	Bank of Japan			DECEMBER		
10	Bank of England			2	Reserve Bank of Australia	
16	Bank of Canada			3	Bank of Brazil	
24	Reserve Bank of New Zealand			3	Bank of Canada	
25	Bank of Mexico			4	European Central Bank	
30	Bank of Japan			4	Bank of England	
30	Federal Reserve			5	Bank of Mexico	
MAY			NOVEMBER			
6	Reserve Bank of Australia			11	Bank of Norway	
8	European Central Bank			11	Reserve Bank of New Zealand	
8	Bank of England			11	Swiss National Bank	
8	Bank of Norway			15	Bank of Sweden	
21	Bank of Japan			17	Federal Reserve	
28	Bank of Brazil			19	Bank of Japan	
JUNE			NOVEMBER			
3	Reserve Bank of Australia			4	Reserve Bank of Australia	
4	Bank of Canada			6	European Central Bank	
5	European Central Bank			6	Bank of England	
5	Bank of England			19	Bank of Japan	
6	Bank of Mexico			DECEMBER		
12	Reserve Bank of New Zealand			2	Reserve Bank of Australia	
13	Bank of Japan			3	Bank of Brazil	
18	Federal Reserve			3	Bank of Canada	
19	Bank of Norway			4	European Central Bank	
19	Swiss National Bank			4	Bank of England	

NOTE: Certain banks may decide to change rates in-between the scheduled meetings. The abbreviations s.q. and b.p. correspond to status quo and basis points respectively.